Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: H.B. 69 of the 129th G.A. **Date**: February 16, 2011

Status: As Introduced **Sponsor**: Rep. Wachtmann

Local Impact Statement Procedure Required: Yes (corrected after initial determination)

Contents: To make changes to the law governing the state retirement systems

State Fiscal Highlights

- The provisions that increase employee contribution rates for members participating in the State Teachers Retirement System (STRS), the Ohio Police and Fire Pension Fund (OP&F), and the Highway Patrol Retirement System (HPRS) would reduce personal income tax receipts. An employee's contributions that are withheld from the employee's paycheck and paid to the systems are not taxable currently. Thus, these provisions would reduce personal income tax receipts for several years, by an amount increasing over five years as the rate increases are phased in, to approximately $12.8 million per year starting in the fifth year. The state GRF would bear 94.1% of any revenue loss while the Local Government Fund (LGF) and Public Library Fund (PLF) would bear 3.68% and 2.22%, respectively.
- The provisions requiring public employers that contribute to the Public Employees Retirement System (PERS) to comply with certain administrative requirements may minimally increase the state's administrative costs.
- Approximately 96% of state employees are members of PERS, 2.5% are members in HPRS, and the remaining 1.5% are in STRS.
- Most provisions would decrease the retirement systems' pension benefit expenditures, thereby generating savings for the systems. The resulting decrease in liabilities is likely to decrease future state spending to provide retirement benefits to employees, contingent on an actuary's determination that the savings are sufficient to reduce contribution rates. Due to this contingency, LSC staff consider any such fiscal effects to be indirect. Under existing law, the board of each of the retirement systems is required to prepare an actuarial analysis of any introduced legislation

expected to have a measurable financial impact on the system by not later than 60 days from the date of introduction of the legislation.[1]

Local Fiscal Highlights

- The provisions that increase employee contribution rates for members participating in STRS, OP&F, and HPRS would reduce state personal income tax receipts. The amount of the reduction would increase over the five-year phase-in period, to approximately $12.8 million per year starting in the fifth year. The state GRF would bear most of the revenue loss, but the Local Government Fund (LGF) and Public Library Fund (PLF) would bear $0.5 million and $0.3 million, respectively, of the state personal income tax revenue loss. Any revenue loss to the LGF and PLF would subsequently reduce the allocations to various local government entities.
- The provisions that increase employee contribution rates for those systems would also decrease school district income taxes, for those school districts that impose them and in which members of the affected retirement systems reside. This occurs for the same reason as the reduction in the state personal income tax.
- The provisions requiring public employers that contribute to PERS to comply with certain administrative requirements may minimally increase local government employers' administrative costs.
- The provision that increases the frequency for remitting employer contributions to the OP&F to monthly rather than quarterly may minimally increase administrative costs for local government employers affected by the provision.
- All local government employees are either a member of PERS or OP&F, while most school districts' employees are members of STRS or the School Employees Retirement System (SERS).
- Most provisions would decrease the retirement systems' pension benefit expenditures, thereby generating savings for the systems. The resulting decrease in liabilities is likely to decrease local governments' spending to provide retirement benefits to employees, contingent on an actuary's determination that the savings are sufficient to reduce contribution rates. Due to this contingency, LSC staff consider any such fiscal effects to be indirect.

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[1] A copy of the actuarial analysis must be submitted to the Legislative Service Commission (LSC), the Ohio Retirement Study Council (ORSC), and the standing committees of the House of Representatives and the Senate with primary responsibility for retirement legislation.

Detailed Fiscal Analysis

The bill makes various changes to law governing the five state retirement systems. The systems are: the Public Employees Retirement System (PERS), the State Teachers Retirement System (STRS), the School Employees Retirement System (SERS), the Ohio Police and Fire Pension Fund (OP&F), and the Highway Patrol Retirement System (HPRS).

The provisions that increase employee contribution rates for members participating in STRS, OP&F, and HPRS would reduce receipts from the state personal income tax and from school district income taxes, as described in more detail below. Most of the other provisions have no significant direct fiscal effect on the state and local governments. At a given point in time, state and local contributions to the retirement systems are based on the size of their respective payrolls, which are multiplied by a contribution rate determined by an actuary; for example, the employer contribution rate under PERS is currently 14%. The bill's provisions generally create savings for the retirement systems, and it is likely that those savings will reduce future required contribution rates, but any such reduction is contingent on an actuary's determination. Because of the contingent nature of the savings to the state and to political subdivisions, LSC staff consider such fiscal effects to be indirect. However, some provisions requiring public employers to comply with certain administrative requirements may minimally increase the state and local governments' administrative costs.

The LSC bill analysis provides a detailed description of this bill. The following are provisions that have a fiscal effect on the state or on political subdivisions, or a major fiscal effect on the retirement systems, and are organized by system.

PERS[2]

- Modifies age and service retirement benefit eligibility criteria. Under the new criteria, a member is generally required to attain an additional two years of service credit or of age to be eligible to retire. Requires members retiring based on 32 or more years of service credit to be at least age 55.
- Changes the final average salary (FAS) used to calculate a member's benefit from the average of the three highest calendar years' salary to the average of the five highest calendar years of earnable salary.
- Increases the number of years of service credit required to receive a higher benefit multiplier, 2.5% of FAS, from 30 years of service credit to 35 years (the

[2] The bill classified PERS members into two groups: "Group I" are PERS members who, on the bill's effective date, are eligible to retire or, using current criteria, will be eligible to retire not later than ten years after the bill's effective date or on that date have 20 or more years of total service credit. Members in "Group II" are PERS members who do not meet the criteria for Group I or become PERS members after the bill's effective date. Most of the provisions apply to Group II members.

higher multiplier is applied to years of service in excess of the 30-year or 35-year threshold).

- Changes an annual cost-of-living adjustment (COLA) for benefits granted five years after the bill's effective date. The new COLA equals any increase in the Consumer Price Index (CPI) for the immediately preceding year, not exceeding 3% annually, instead of the automatic 3% under existing law.
- Increases the amount a PERS member must earn in a month to receive full credit for that month from $250 to $1,000 and provides for future increases in this threshold based on increases in the cost of living. Revises a member's eligibility and increases the cost to purchase certain service credit. A member or former member who purchases such credit would be required to pay an amount equal to 100% of the additional liability to PERS resulting from the additional credit.
- Revises disability benefits coverage and eligibility, generally restricting eligibility for such benefits.
- Expands the current limited forfeiture of a retirement allowance or disability benefit by a PERS member who has been convicted of a felony that caused the member's physical or mental disability after the bill's effective date.
- Requires each public employer who is a member of PERS, to prepare a report containing a list of individuals providing personal services who at any time during the preceding year received compensation for which contributions were not made to PERS. The report must be submitted to PERS by not later than the last day of January of each year.

STRS[3]

- Increases member contributions by 0.5% of salary per year beginning on July 1, 2011, to a total increase of 2.5% on July 1, 2015. Currently, STRS Ohio members pay 10% of their salaries to STRS.
- Revises age and service retirement benefit eligibility criteria beginning August 1, 2015. Increases the requirement for an unreduced retirement benefit from 30 to 35 years of service credit and increases the requirement for early retirement with a reduced benefit from 25 to 30 years of service credit at age 55.
- Increases the number of years used to determine FAS, used to calculate a member's benefit, from three to five, beginning August 1, 2015.
- Reduces the annual COLA from 3% to 2% for those retiring no later than July 31, 2011, and reduces it to 1.5% for STRS members retiring on or after August 1, 2011.

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[3] The bill allows an STRS member who under current law would be eligible to retire on July 1, 2015 to retire on or after August 1, 2015 under current law's eligibility and benefit provisions.

- Reduces the benefit multiplier to 2.5% of FAS for each year of service credit beyond 30 years, instead of 2.5% plus an amount increasing by 0.1% of FAS for each year beyond 30, beginning August 1, 2015.

SERS

- Modifies the years of service and age requirements for both reduced and unreduced retirement for members hired before May 14, 2008, to make them the same as for those hired on or after that date.
- Establishes a minimum retirement age of 57.
- Uses an actuarial equivalent to determine a reduced benefit for early retirement instead of a percentage as specified by current law.
- All of the changes would affect all SERS members effective July 1, 2015.

OP&F

- Increases police officer and firefighter contributions by increments from 10% to 12% of salary beginning with the payroll period ending not later than 31 days after the bill's effective date.
- Modifies age and service retirement benefit eligibility criteria for OP&F members hired on or after January 1, 2011. Increases the age requirement for an unreduced retirement benefit with 25 years of service to age 52, rather than 48. Establishes an early (reduced) retirement benefit for members with 25 years of service credit and age 48.
- Provides that, in calculating average annual salary (AAS), five years (rather than three) is to be used for members who have less than 15 years of active service on January 1, 2011.
- Delays to age 55, eligibility for a COLA for a retirement pension or disability benefit recipient. Provides that a member must have attained age 52 (rather than be eligible to retire) to participate in the deferred retirement option plan (DROP) and must participate in the plan for six years (rather than four) to receive the entire DROP accrual.
- Increases the frequency for remitting employer contributions to OP&F to monthly rather than quarterly. The new remittance schedule is effective for payrolls paid on or after the 91st day after the bill's effective date.

HPRS

- Increases the contribution rate for Highway Patrol Retirement System (HPRS) members to 11% of salary (from 10%).
- Increases the number of years used in determining final average salary (FAS) to five (from three) for use in determining benefits.

- Reduces the annual COLA to 2% (from 3%), except in certain instances, and provides that no recipient of an HPRS pension (including those receiving a disability or survivor pension) is to receive a COLA before attaining age 60.
- Provides that, for deferred retirement option plan (DROP) participants, the additional 1% of contribution required by the bill is to be deposited in the HPRS Employer Accumulation Fund and not to accrue to the benefit of the member.

Fiscal impact

State and local governments

The provisions that increase employee contribution rates for members participating in STRS, OP&F, and HPRS would reduce receipts from the state personal income tax and from school district income taxes, if the local employer treats such contributions as a salary reduction employer pick-up plan (as the state does under PERS, for example). Table 1 shows proposed member contribution rates and the amount of member contributions, by system. Employees' contributions that are withheld from such employees' paychecks and paid to the systems are treated as tax deferred, and thus not taxable income currently. Any increase in employee contribution rates would correspondingly increase total amounts of payroll that are not taxed currently, thereby decreasing state personal income tax receipts. The state GRF would bear 94.1% of any revenue loss while the LGF and the PLF would bear 3.68% and 2.22%, respectively.

Using member contributions in Table 1 below, the estimated amount of payroll that would effectively shift from taxable to nontaxable would be up to $65 million in the first year, increasing each year to up to $313 million per year starting in the fifth year. Assuming a marginal tax rate of 4.1%,[4] state personal income tax revenue would decrease by up to $12.8 million per year after five years. The state GRF would bear up to $12.1 million of such revenue loss while the LGF and the PLF would bear about $0.5 million and $0.3 million, respectively. Any revenue loss to the LGF and PLF would subsequently reduce the allocations to various local government entities. Because school district income taxes are determined starting with Ohio Taxable Income, the provision would also decrease school districts' income tax receipts.

[4] According to data from the most recent STRS, OP&F, and HPRS annual reports, the average member's salary is between $50,000 and $70,000 annually, depending on the retirement system.

Table 1: Proposed Employee Contribution Rates, by Retirement System[5]			
System	Current Member Contribution Rate	Member Contributions ($ in millions)	H.B. 69 Proposed Contribution Rates
STRS	10.0%	$1,112.5	12.5% (increases phased in by 0.5% per year, over five years, beginning July 1, 2011)
OP&F	10.0%	$168.4	12% (increases phased in by 0.5% per year, over four years, beginning on the 31st day after the bill's effective date)
HPRS	10.0%	$8.6	11% (increase beginning on the effective date of the bill)

Most of the provisions would have no direct fiscal impact on the state, local governments, and school districts because the bill does not make any changes to employers' contribution rates. Thus, the bill would not directly affect the state's, local governments', and school districts' retirement costs. Retirement benefits for a public employee are funded by a combination of employees' and employers' contributions and investment earnings on those contributions. Employee and employer contribution rates are based on a set percentage of employees' payroll. The rates are determined by an actuary as the percentage necessary to fully fund benefit amounts over time, but limited to the maximum rates specified in the Revised Code.[6] Table 2 (below) shows employees' and employers' contribution rates in 2011, by system.

Table 2: Contribution Rates in 2011, by Retirement System			
System	Division	Employee Contribution Rate	Employer Contribution Rate
PERS	State	10.0%	14.0%
	Local	10.0%	14.0%
	PERS Public Safety	11.0%	18.1%
	PERS Law	11.6%	18.1%
STRS		10.0%	14.0%
SERS		10.0%	14.0%
OP&F	Police	10.0%	19.5%
	Fire	10.0%	24.0%
HPRS		10.0%	26.5%

Many of the bill's provisions would decrease the retirement systems' liabilities (see relevant section below). By doing so, those provisions would likely permit an actuary to determine, at some point, that employer contribution rates could be reduced,

[5] Amounts for STRS are as of FY 2010 while OP&F and HPRS are as of December 31, 2009.

[6] Currently, a portion of an employer's contributions is used to fund retirees' optional health benefits provided by the systems.

thereby decreasing future costs for the state and political subdivisions. LSC does not employ an actuary, and does not have access to employee-level data with which to estimate the likely magnitude and timing of any such reduction in contribution rates. Also, due to the fact that such reductions are contingent on an actuary's analysis and determination, LSC would consider such reductions to be indirect fiscal effects.

Several provisions requiring public employers to comply with certain administrative requirements, summarized below, may increase the state's and local governments' administrative costs. Any such increases are expected to be minimal.

First, the bill requires each public employer who is a member of PERS, to prepare a report containing a list of individuals providing personal services who at any time during the preceding year received compensation for which contributions were not made to PERS. This provision may minimally increase the state and local governments' administrative costs.

Second, the bill expands the current limited forfeiture of a retirement allowance or disability benefit by a PERS member who has been convicted of a felony by creating a new forfeiture provision applicable to a member convicted of a felony, committed after the bill's effective date that caused the member's physical or mental disability. This provision may have a minimal fiscal impact on local governments due to the requirement that a court must hold a hearing regarding the condition for which an offender was granted a disability benefit and due to related notification requirements.

And third, it increases the frequency for remitting employer contributions to OP&F to monthly rather than quarterly. The monthly reporting requirement provision will decrease local governments' monthly cash flow that may be used for investment or other purposes before the employer contributions are remitted to OP&F. However, the estimated amount of forgone revenue from earnings on investment will depend on several factors, including the amount of funds available for investment and interest rates on the investment. The provisions may also increase local governments' expenditures if they fail to pay the contributions on time, due to penalties that OP&F is required to assess for late payments. The provision would have no fiscal impact on the state because state employees and employers do not contribute to OP&F.

Retirement systems

The majority of the bill's provisions, when they begin to take effect, would decrease the systems' pension benefit expenditures. This in turn would decrease the systems' pension liabilities and the number of years to amortize their unfunded actuarial accrued liabilities (UAAL). A UAAL occurs when the value of the actuarial accrued liabilities exceeds the value of assets. UAAL is calculated by an actuary based on various economic and actuarial assumptions. In the cases of STRS, OP&F, and HPRS, the bill would require increased employee contributions. Thus, the bill would improve the long-term funding status of each of the five systems. The magnitude of the impacts on each system's liabilities and UAAL would need to be determined by an actuary, and is undetermined at this time.

Under current law, each system is required to amortize its UAAL over a period not to exceed 30 years.[7] Table 3 below, presents financial data for the retirement systems as of the indicated date of a recent actuarial valuation.[8] The bill may also increase the systems' administrative costs, however any potential cost due to the bill would be offset by savings realized by the systems.

Table 3: Financial Data, by Retirement System ($ in millions)			
System	**UAAL ($ in millions)**	**Funded Ratio[9]**	**Funding Period for Pension**
PERS (as of 12/31/2009)	$18,925.6	75.3%	PERS Total: 30 years (State: 42 years, Local: 25 years, Public Safety: infinite, and Law Enforcement: 24 years)
STRS (as of 6/30/2010)	$38,774.4	59.1%	Infinite
SERS (as of 6/30/2010)	$4,312.5	72.6%	29 years
OP&F (as of 1/1/2010)	$4,036.7	72.8%	Infinite
HPRS (as of 12/31/2009)	$319.7	66.0%	Infinite

In the future, if the systems maintained a 30-year amortization and their funding status remained stable, it would lessen the chances of further increase in contribution rates or reductions in benefits.[10] Thus, the bill may indirectly affect employer (state, local governments, and school districts) and employee contributions in the future, as described above.

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[7] The Revised Code specifies that in any year a system's funding period exceeds the 30-year requirement, the system is required to submit a report to the Ohio Retirement Study Council outlining its plans to comply with the 30-year funding requirement. UAAL is calculated by an actuary based on various economic and actuarial assumptions.

[8] Funding period is the number of years needed to fully amortize pension liabilities.

[9] A funded ratio represents ratio of assets to actuarial accrued liabilities, and is an indicator of the fiscal strength of a retirement system,

[10] In general, investment earnings account for about two-thirds of total revenues to pay for retirement benefits. Thus, investment returns have a significant and direct impact on future contribution rates.